No. 62

IN THE

Supreme Court of the United States

OCTOBER TERM, 1944

SPECTOR MOTOR SERVICE, INC.,
Petitioner,

v.

CHARLES J. McLAUGHLIN, TAX COMMISSIONER,
WALTER W. WALSH, SUBSTITUTED DEFENDANT,
Respondent.

ON APPEAL FROM THE UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE SECOND CIRCUIT AND CERTIORARI

BRIEF OF RESPONDENT

FRANCIS A. PALLOTTI,
Attorney General
FRANK J. DiSESA,
Assistant Attorney General
Counsel for Respondent

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To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

Opinions Below

The Opinion of the United States District Court (R. 94) is reported in 47 Fed. Supp. 671. The Opinion of the United States Circuit Court of Appeals for the Second District (R. 109) is reported in 139 Fed. (2d) 809.

Jurisdiction

The judgment of the United States District Court was entered December 19, 1942. Notice of appeal to the United States Circuit Court for the Second Circuit was filed January 29, 1943. The Petition for Certiorari was filed April 18, 1944 and granted on May 22, 1944. The jurisdiction of the United States District Court was invoked under 28 U. S. C., Sec. 41 (1), and the Declaratory Judgment Act, 28 U. S. C., Sec. 400. The jurisdiction of the Court of Appeals was invoked under 28 U. S. C., Sec. 225. The jurisdiction of this Court is invoked under 28 U. S. C., Sec. 347 (a).

Statutes Involved

Because they are lengthy the relevant portions of the Corporation Business Tax Act of 1935 involved are set forth in Appendix A of this brief. They are Sec. 418c of the 1935 Cum. Supp. to the General Statutes as amended by Sec. 176F of the 1941 Supp. to the General Statutes and Secs. 419c and 420c of the 1935 Supp. to the General Statutes, Revision of 1930.

Question Presented

The petitioner is a Missouri corporation with its principal place of business in Chicago, Illinois and is engaged in interstate trucking of freight with terminals in Connecticut, and the question presented is whether, under the facts existing in this case, the petitioner is subject to the assessment of taxes against it under Sections 418c, 419c and 420c of the 1935 Cumulative Supplement to the General Statutes, Revision of 1930, on business carried on by it within the State of Connecticut or on revenue derived by it from the State of Connecticut; in other words, whether the Connecticut Corporation Business Tax Act of 1935, which is based fundamentally on net income allocated and attributed to the business done within the State, is valid as applied to the Spector Motor Service, Inc., a concern engaged in interstate trucking and with terminals in Connecticut.

Statement

Action was brought by the Spector Motor Service, Inc. to enjoin the Tax Commissioner from assessing and enforcing the collection of taxes, interest and penalties under the Corporation Business Tax Act of 1935, as amended.

In 1933 the petitioner was incorporated as a Missouri corporation with its principal place of business in St. Louis, Missouri. At the time suit was instituted, and for some time prior thereto, its principal place of business was located in Chicago, Illinois. Under an Interstate Commerce Commercial Permit it engaged in interstate trucking of freight. In the

development of its business it established terminals in the East where goods were collected, sorted and arranged so that instead of a truck, which had been driven to the East loaded, being driven back empty or with less than a full load, the truck was returned to the West with a full load. This system is called a "two-way haul".

The petitioner rented terminals for its exclusive use in Chicago, Illinois, New York City, New Britain, Connecticut and Bridgeport, Connecticut, in addition to those already established in St, Louis, Missouri, and New York City. It also acquired agency terminals where it had the use of terminal facilities of carriers in Boston, Springfield and Worcester, Massachusetts, Saylesville, Rhode Island, and Newark, New Jersey. Petitioner operates about 150 trucks in its interstate trucking, almost all of which are leased from the Wallace Transport Company of Illinois, its corporate affiliate, but the drivers of the trucks are employees of petitioner.

The officers of Spector Motor Service, Inc. and their wives own all of the stock of the Wallace Transport Company and the petitioner originally purchased the trucks for the Wallace Transport Company (R. 30). Where shipments smaller than truck loads are involved, these trucks are loaded and unloaded at the terminals, to or from which the goods are brought or delivered by separate pickup trucks, some of which are leased from local truckers and some of which are owned by the petitioner. At the New Britain terminals the petitioner has five such pickup company trucks, all owned by it on conditional bills of sale.

Petitioner employs ten people at the Bridgeport terminal and seventeen at the New Britain terminal. These employees include a general manager, sales solicitor, and loading and accounting personnel. These employees handle the freight originating at and destined to that point. Petitioner has a bank account at Bridgeport for depositing its drivers' receipts, but no Connecticut employee has authority to disburse this money.

The New Britain office handles the accounts receivable for all of the New England territory that materialize as a result

of shipments moving in and out of Bridgeport, New Britain, Springfield, Worcester, Providence, Boston and Haverhill, as all such accounts go into the New Britain office (R. 44). The Chicago office or the St. Louis office bill for all freight charges that are not prepaid in Connecticut. Approximately 50% of all shipments are handled in this manner in Connecticut. Expenses and employees' wages are paid by draft on petitioner at Chicago, although a small amount of cash is kept in New Britain to cover incidental expenses. Local personal property taxes on property upon which petitioner has placed a value of $1,500.00 are paid by it in New Britain. This property consists of office equipment and, with the exception of the pickup trucks, comprises the entire physical assets of the petitioner in Connecticut for it owns no real estate in the State.

In 1934 the petitioner's landlord at the New Britain terminal required the petitioner to file with the Secretary of the State of Connecticut a certificate of its incorporation in the State of Missouri and a certificate appointing the Secretary its attorney for service of process in Connecticut pursuant to Section 3488 of the General Statutes of the State of Connecticut, Rev. 1930. Petitioner paid the annual statutory fee of $50.00 and has continued to pay the annual fee. The petitioner never applied for or received a certificate of public convenience and necessity from the Public Utilities Commissioner of Connecticut. The total assessment, including interest and penalties laid against the petitioner for the period from June 1, 1937 to December 31, 1940 aggregated $7,795.50 as of January 7, 1942. (Par. 17, Finding, R. 103).

From 1936 through 1940 the following percentage and amount of the gross business of the petitioner originated in, is attributable to, and is derived from the State of Connecticut:

1936—47% or $111,709.97 of a total business of $233,787.78.
1937—37.86% or $166,610.06 of a total business of $440,025.92.
1938—(1st 5 mos.)—47% or $150,296.95 of a total business of $318,786.85.
1938—(7 mos.)—50% plus or $218,471.73 of a total business of $432,087.39.

1939—42% or $505,777.47 of a total business of $1,202,210.35. 1940—34% or $587,973.59 of a total business of $1,723,510.65. (R. 60, 66, 71, 72).

It will be seen that between one-third and one-half of the dollar volume of petitioner's business originates in Connecticut. (Opinion of District Court, R. 95. Par. 7 Finding, R. 101).

The petitioner operated only over routes approved by the Interstate Commerce Commission, of which from 3% to 10% of petitioner's route mileage was within the State of Connecticut. (Par. 8 Finding, R. 101). It carried freight only from points within one State to points within another State, and carried no freight from a point within Connecticut to another point in Connecticut for final delivery. It paid personal property taxes upon its office equipment at New Britain of from $40.00 to $60.00. At New Britain petitioner applied at the Rationing Board of the Office of Price Administration for tires and received them (R. 87-94).

The Connecticut Corporation Tax being a franchise tax measured by net income, the Tax Commissioner assessed a tax against petitioner on the business done within the State and the income derived from the State.

The United States District Court granted petitioner's prayer for an injunction against the assessment and collection of the tax and for an adjudication that it was not liable for the tax and rendered judgment in favor of the petitioner on the ground that the tax was an unconstitutional burden on interstate commerce. (47 Fed. Supp. 671). It found that the petitioner was engaged solely in interstate business, that no intrastate business was done by the petitioner and the Act therefore did not apply to it. The respondent appealed to the United States Circuit Court of Appeals for the Second Circuit and the Court reversed the judgment of the District Court. The Court held that the levy upon the petitioner was only of a nondiscriminatory tax upon income fairly attributable to interstate business in Connecticut and as such was valid. A dissenting opinion was filed. (139 Fed. (2d) 809).

Summary of Argument

1. The Act is intended to apply to such corporations as the petitioner.

2. Petitioner carries on its business in large part in Connecticut and in return for the protection given it Connecticut may require it to carry its share of the tax burden and pay a tax based on that part of its corporate net income derived from its activities in Connecticut.

3. Lack of a certificate of public convenience and necessity does not exempt petitioner from paying the tax.

4. A state may tax a foreign corporation engaged solely in interstate commerce.

5. The Act applies to domestic and foreign corporations alike and is not discriminatory.

6. The computation of the tax is fairly calculated to assign to Connecticut that portion of net income derived from Connecticut.

7. The statute was properly applied to the petitioner by the Tax Commissioner.

8. The possibility that other states may tax the petitioner does not excuse it from paying the tax.

9. Conclusion.

Argument

I

The Act is intended to apply to such corporations as the Petitioner.

The Connecticut legislature intended that the tax be applicable to domestic as well as foreign corporations and corporations doing business within and without the state and the Tax Commissioner has so applied the Act since its enactment (R. 76, 77, 80). The Report of the Connecticut Temporary Commission To Study The Tax Laws, 1934, raised by Special Act in 1933 (Vol. 21 Special Laws, p. 1443, R. 76) recommended the tax and therein considered the application of the tax to interstate commerce and set forth its thoughts on this subject on pages 455, 456 (Appendix B). Also see Stanley Works v. Hackett, 122 Conn. 547 (1937). In enacting Section 418c the legislature adopted the recommendations of the Temporary Tax Commission, for the Connecticut Corporation Business Tax Act of 1935 places a tax on every corporation "carrying on business in this state" which has to file a report for federal income tax purposes, with certain exceptions not material here, "annually, a tax or excise upon its franchise for the privilege of carrying on or doing business within the state, such tax to be measured by the entire net income as herein defined received by such corporation or association from business transacted within the state during the income year and to be assessed at the rate of two per cent". It made further provision for a minimum tax, more specifically defined in Sections 421c and 422c. Its intention to have the tax apply to corporations such as petitioner is further shown when in 1937 the legislature amended Section 418c to include all corporations having "the right to carry on business" in Connecticut as well as those actually carrying on business in the state. See 176F, 1941 Supp. to Gen. Stat., Rev. 1930.

Net income is defined in Section 419c as gross income less the deductions under the federal corporation net income tax

and excepts (1) federal taxes on income or profits, losses of prior years, interest received from federal, state and local government securities and specific exemptions, if any such deductions shall be allowed by the federal government and (2) interest and rent paid during the income year. Section 420c provides that as to those corporations whose trade or business is carried on partly without the state, the tax shall be imposed on a base "which reasonably represents the proportion of the trade or business carried on within the state". Such specific receipts as interest, dividends, royalties and gains on sales of assets are allocated to the state of the principal place of business unless it is clearly established that they are derived from local business or are sales or rentals of tangible property within the state. The tax commissioner is given the authority to promulgate rules and regulations for the allocation of the remainder of net income, except in the case of income "derived from the manufacture, sale or use of tangible personal or real property". The portion to be attributed to "business within the state" in the latter case is determined by an allocation fraction which is simply the mean or average of three ratios: (1) the ratio of tangible property in Connecticut to all tangible property, (2) the ratio of wages and salaries paid within Connecticut to all wages and salaries, and (3) the ratio of gross receipts from business done in Connecticut to all other gross receipts (excluding income from interest, dividends, royalties, gains from sales of intangible assets and gains from sales or rentals of tangible capital assets).

A minimum tax set up as an alternative to Section 418c is provided for in Section 421c and requires the corporation to pay whichever is the greater, either the tax defined in Section 418c or the tax defined in Section 421c of one mill per dollar based on the issued and outstanding capital stock, surplus, undivided profits, reserves, interest-bearing indebtedness, less any deficit appearing in the balance sheet and amounts invested in shares of stock of other corporations. The rate of tax is one mill per dollar on the net amount. Incidentally the rate of tax on corporations doing business in Connecticut is

among the very lowest of the 32 states which impose a franchise tax on corporations in this country. The minimum tax is not involved here but tends to show the intent of the legislature that a fair system be devised for the allocation between business within and without the state and the intent to place upon corporations what it thought would be its fair portion of the tax. Section 422c provides for the allocation of a minimum tax as applied to corporations carrying on business partly without the state. Lenox Realty Co. v. Hackett, 122 Conn. 143.

II

Petitioner carries on its business in large part in Connecticut and in return for the protection given it Connecticut may require it to carry its share of the tax burden and pay a tax based on that part of its corporate net income derived from its activities in Connecticut.

The legislation having been enacted with the intent that it apply to corporations like the petitioner, the question of its validity as applied to the petitioner by the commissioner becomes paramount.

The Court will always construe a statute so as to uphold its validity where possible. Anniston Mfg. Co. v. Davis, 301 U. S. 337; Federal Trade Comm. v. American Tobacco Co., 264 U. S. 298; Panama R. Co. v. Johnson, 264 U. S. 375; Blodgett v. Holden, 275 U. S. 142; Ferguson v. Stamford, 60 Conn. 432.

Those engaged in interstate commerce must pay their just share of a state tax burden. Western Live Stock v. Bureau of Revenue, 303 U. S. 250; Postal Telegraph-Cable Co. v. Richmond, 249 U. S. 252; McGoldrick v. Berwind-White Coal Mining Co., 309 U. S. 33; General Trading Co. v. State Tax Com'r of Iowa, 64 S. Ct. 1028; Underwood Typewriter Co. v. Chamberlain, 254 U. S. 113, affirming 94 Conn. 47; Butler Bros. v. McColgan, 315 U. S. 501; Atlantic Coast Line R. Co. v. Doughton, 262 U. S. 413; Matson Nav. Co. v. State Board of

Equalization, 297 U. S. 441; Memphis Natural Gas Co. v. Beeler, 315 U. S. 649; Bass, Ratcliff and Gretton v. State Tax Commission, 266 U. S. 271.

In Underwood Typewriter Co. v. Chamberlain, 254 U. S. 113, affirming 94 Conn. 47, the Court upheld as not violative of the Commerce Clause, Article I, Sec. 8, or of the Fourteenth Amendment a Connecticut statute which placed a tax upon the proportion of the net profits of a foreign corporation earned by operations conducted within Connecticut. The corporation did an intrastate and interstate business. The act involved was Part IV of Chapter 292 of the Public Acts of 1915, Gen. Stat. 1918, Sec. 1391-1395. The tax statutes now before this Court for consideration have taken the place of said statutes. It was a Delaware corporation and had its manufacturing plant in Connecticut, stored all its goods in warehouses in Connecticut, and had one branch office in Connecticut. It had a principal office in New York City. It had branch offices in other states for the sale, lease and repair of machines and sale of supplies. It shipped its goods from Connecticut direct to the branch offices, purchasers or lessees. The Court held, that although the foreign corporation manufactured its product within Connecticut and derived the greater part of its receipts from sales outside the state, the tax which attributed to processes conducted within the state the proportion of the total net income which the value of real and tangible property owned by the corporation within the state bore to the value of all its real and tangible personal property was not inherently unreasonable and calculated to tax income earned beyond the borders of the state and was constitutional. This case was later considered by the Court with approval in Memphis Natural Gas Co. v. Beeler, 315 U. S. 649, 656 (1942) and Butler Bros. v. McColgan, 315 U. S. 501, 507 (1942).

In Memphis Natural Gas Co. v. Beeler, 315 U. S. 649, 656 the Court said:

> In any case, even if taxpayer's business were wholly interstate commerce, a nondiscriminatory tax by Tennessee upon the net income of a foreign corporation

having a commercial domicile there, cf. Wheeling Steel Corp. v. Fox, supra, (298 U. S. 193), or upon net income derived from within the state, Shaffer v. Carter, 252 U. S. 37, 57; Wisconsin v. Minnesota Mining Co., 311 U. S. 452; cf. New York ex rel. Cohn v. Graves, 300 U. S. 308, is not prohibited by the commerce clause on which alone taxpayer relies. U. S. Glue Co. v. Oak Creek, 247 U. S. 321; Underwood Typewriter Co. v. Chamberlain, 254 U. S. 113, 119-20; cf. Bass, Ratcliff & Gretton, Ltd. v. Tax Comm'n, 266 U. S. 271; Western Live Stock v. Bureau, 303 U. S. 250, 255. There is no contention or showing here that the tax assessed is not upon net earnings justly attributable to Tennessee. Underwood Typewriter Co. v. Chamberlain, supra; cf. Bass, Ratcliff & Gretton, Ltd. v. Tax Comm'n, supra; Butler Bros. v. McColgan, ante, p. 501 (315 U. S. 501). It does not appear that upon any theory the tax can be deemed to infringe the commerce clause." (Parenthetical matter ours.)

It is true that the Spector Company hauled freight from points inside Connecticut only to points outside Connecticut. However, it is in and from Connecticut that it draws its life-blood and the business which sustains it. In 1936 more than 47% of its entire income originated in or was attributable to business done in Connecticut; in 1937, 38%; and during 1938 an average of 48½% or 50% for the first five months and 47% for the last seven months. Its Connecticut business in 1939 was 42% and in 1940, 34% of its total business. The residents and industries of Connecticut furnish petitioner with this large amount of its gross annual business. In Connecticut it maintains and operates two large terminals staffed with its own employees. It owns five trucks which are kept and operated solely in Connecticut. It solicits sales, enters into leases and contracts, pays its employees, pays local taxes, keeps a bank account, handles all accounts receivable for the entire New England territory, uses local trucking facilities under contracts, and, in short, does about all any domestic corporation would do in the operation of its business. In addition, it has qualified itself to do business within the state by registering with the Secretary of the State and paying the annual fee to maintain such qualification.

Instead of maintaining a manufacturing plant as in the Underwood Typewriter Co. case, it maintains terminals. The fact that it leases the terminals and does not own them is immaterial for it exerts full ownership and operational rights over them.

In General Trading Co. v. State Tax Comm. of Iowa, 64 S. Ct. 1028, a Minnesota corporation had no place of business or agent located in Iowa and never qualified to do business in Iowa, it merely sent its agents into Iowa to solicit sales orders. The Court upheld the ruling of the state court that the corporation came within the language of the statute and was a "retailer maintaining a place of business in the state".

The petitioner has established a commercial domicile in Connecticut and Connecticut may tax its net income derived from business done within the state if the tax is non-discriminatory. Memphis Natural Gas Co. v. Beeler, 315 U. S. 649; Wheeling Steel Corp. v. Fox, 298 U. S. 193.

This is so even if all the taxpayer's business is wholly interstate commerce. Shaffer v. Carter, 252 U. S. 37; Wisconsin v. Minnesota Mining Co., 311 U. S. 452; New York ex rel Cohn v. Graves, 300 U. S. 308.

Where a large portion of the income of a foreign corporation is derived from business done in a state, the net income of such business may be taxed if the tax is fairly apportioned and non-discriminatory. Western Live Stock v. Bureau of Revenue, 303 U. S. 250; Wisconsin, et al v. Minnesota Mining & Mfg. Co., 311 U. S. 452; U. S. Glue Co. v. Town of Oak Creek, 247 U. S. 321; Memphis Natural Gas Co. v. Beeler, 315 U. S. 649; Butler Bros. v. McColgan, 315 U. S. 501; Matson Nav. Co. v. State Bd. of Equalization, 297 U. S. 441; Peck v. Lowe, 247 U. S. 165. It appears therefore that even though it may be found that the petitioner has no commercial domicile in Connecticut, the statutes still apply to it.

In Ford Motor Co. v. Beauchamp, 308 U. S. 331, the Ford Motor Company was engaged in both intrastate and interstate business and the Court upheld a Texas franchise tax based on the proportion of capital assets of the Company lo-

cated in Texas and an allocation fraction was used with the result that a figure of $23,000,000 was reached although the actual value of the Company's assets was only in the neighborhood of $3,000,000. As pointed out by the Circuit Court of Appeals, this decision leads to the logical conclusion that a substantial tax may be levied on the interstate business if a minimum of intrastate business is done and the Court logically concluded that to say the tax should fail if no intrastate business were discovered regardless of the large amount of interstate business carried on in the state the result would reduce the whole theory of interstate taxation to an absurdity. (R. 119, 120).

A state may even tax the gross receipts of a foreign corporation received from interstate transactions consummated within its borders where it treats wholly local transactions similarly. International Harvester Co. v. Dept. of Treasury, 322 U. S. 340.

III

Lack of a certificate of public convenience and necessity does not exempt petitioner from paying the tax.

In qualifying as a foreign corporation with the Secretary of the State, the petitioner became qualified to carry on an intrastate business in Connecticut. With good logic the Circuit Court of Appeals sets forth the reasoning that a certificate of public convenience for the operation of intrastate trucks is at most a police regulation (R. 120). The question of the duty of a foreign corporation to pay this tax should not hinge upon its failure to comply with the state's police regulations, especially as in this case where the petitioner owned property in Connecticut and carried on so extensive a business in the state. This tax is upon the privilege of doing business in a corporate capacity in Connecticut and not upon the business or activities that were the outcome of the privilege. Home Ins. Co. of N. Y. v.

State of New York, 134 U. S. 594; Flint v. Stone Tracy Co., 220 U. S. 107; Michigan v. Michigan Trust Co., 286 U. S. 334; Anglo-Chilean Nitrate Sales Corp. v. Alabama, 288 U. S. 218 (Dissent of Cardozo, J., Brandeis, J.; Stone, J.). Further, Section 176F of the 1941 Cum. Supp. to the General Statutes, Rev. 1930 effective July 1, 1937, amended Section 418c and applies the tax to "every corporation having the right to carry on business in Connecticut." By qualifying to do business in Connecticut, the petitioner became possessed of the "right to carry on business" in Connecticut.

A foreign corporation may be compelled to carry its share of the tax burden even though it increases the cost of doing business. Telegraph-Cable Co. v. Richmond, 249 U. S. 252; Western Union Tel. Co. v. Massachusetts, 125 U. S. 530; Adams Express Co. v. Kentucky, 166 U. S. 171; Old Dominion S. S. Co. v. Virginia, 198 U. S. 299; Pullman's Palace Car Co. v. Pennsylvania, 141 U. S. 18; International Harvester Co. v. Wisconsin Dept. of Tax'n., 88 L. Ed. 1023; Northwest Airlines v. State of Minnesota, 64 S. Ct. 950; General Trading Co. v. State Tax Com'n., 64 S. Ct. 1028.

IV

A state may tax a foreign corporation engaged solely in interstate commerce.

Petitioner contends that it is engaged solely in interstate commerce and because of this the Act as applied to it by the respondent is unconstitutional.

In International Harvester Co. v. Wisconsin Dept. of Tax'n. and Minnesota Mining & Mfg. Co. v. Wisconsin Dept. of Tax'n. 88 L. Ed. 1023 heard as one case, the Court held to be constitutional a Wisconsin act which imposed a tax upon domestic and foreign corporations for the privilege of declaring and receiving dividends out of income derived from property located and business transacted in the

state, the payor corporation being required to deduct the tax from the dividends payable both to resident and non-resident stockholders. A New Jersey and a Delaware corporation were doing business in Wisconsin. The dividends were declared at directors' meetings held outside Wisconsin and the dividend checks were drawn on banks outside Wisconsin. The tax assessment was measured by so much of the dividends as were derived from the portion of the corporate surplus attributed by the tax authorities to income earned by the corporation in Wisconsin. It was held that a state has a right to place a tax upon a corporation measured by so much of its earnings from within the state as it distributes in dividends and to make the tax payable upon distribution to the stockholders. Wisconsin v. J. C. Penney Co., 311 U. S. 435.

It is of course true, as petitioner points out, that every case must be decided upon its own peculiar facts. A strong dissenting opinion was written by Cardozo, J., and concurred in by Brandeis, J. and Stone, J. in Anglo-Chilean Nitrate Sales Corp. v. Alabama, 288 U. S. 218. A New York corporation qualified to do business in Alabama, having its principal place of business in New York. The only property it owned in Alabama was some bags of nitrate soda which it had imported from Chile and stored in Alabama in the original packages. The goods were sold in Alabama by a salesman who solicited orders. Alabama taxed foreign corporations doing business in the State a franchise tax of $2.00 on every $1,000 of the actual amount of capital employed in Alabama. The dissenting opinion upheld the validity of the tax and discussed Ozark Pipe Line Corp. v. Monier, 266 U. S. 555; Crew-Levick Co. v. Pennsylvania, 245 U. S. 292; Alpha Portland Cement Co. v. Massachusetts, 268 U. S. 203; U. S. Glue Co. v. Oak Creek, 247 U. S. 321, 328, among other cases. Throughout this opinion, as is the case with numerous opinions of the Court, each case is determined on its own facts. We have been unable to find a case exactly in line with the one at bar.

In Ozark Pipe Line Corp. v. Monier, 266 U. S. 555, a franchise tax was laid by Missouri upon foreign corporations doing

business there equal to 1 10th of 1% of the par value of its capital stock and surplus employed in the state. In his dissenting opinion, Brandeis, J. said "But a tax is not a direct burden merely because it is laid upon an indispensable instrumentality of such commerce, or because it arises exclusively from transactions in interstate commerce, Transportation Co. v. Wheeling, 99 U. S. 273, 284; Old Dominion S. S. Co. v. Virginia, 198 U .S. 299, 306; or, although laid upon net income derived exclusively from interstate commerce, United States Glue Co. v. Oak Creek, 247 U. S. 321; Shaffer v. Carter, 252 U. S. 37, 57." Also see reference to this case in dissenting opinion in Anglo-Chilean Nitrate Sales Corp. v. Alabama, 288 U. S. 218, at page 236.

In a logical and realistic manner, the Court of Appeals has dealt with the problem of State government expenses and has followed the tax dollar from collection to expenditure, drawing the conclusion that if this tax were stated in the Act to go into the highway fund, its constitutionality would be ensured. It referred to the case of Interstate Busses Corp. v. Blodgett, 276 U. S. 245, where a Connecticut tax was levied upon foreign corporations of 1c per mile travelled within the state. The proceeds of the tax were used for the maintenance of the highways. Objections to the tax were made on the ground that it discriminated against foreign corporations because the tax did not apply to domestic corporations. Domestic corporations paid an excise tax on their gross receipts and a general state income tax which foreign corporations did not have to pay. The tax was declared non-discriminatory and was upheld. It follows that if interstate passenger motor carriers may be taxed by Connecticut for the upkeep of the highways, interstate trucking concerns should be taxable if the money is to be used to maintain the highways.

As a matter of fact, in its summary of state expenditures, the Report of the Connecticut Temporary Commission to Study the Tax Laws, 1934, at page 56, set forth that from 33% to 47% of the state's revenues go into the highway fund in normal times (Appendix B). Logically, one-third to nearly

one-half of the tax assessed against petitioner would be used for highway purposes.

Petitioner relies heavily upon Alpha Portland Cement Co. v. Massachusetts, 268 U. S. 203, (Brandeis, J. dissented) but the facts of this case show that the corporation simply maintained an office in Massachusetts for the headquarters of its travelling salesmen. This office merely sent the orders on. No samples or other merchandise were kept in Massachusetts. There is a great deal more substance to the business done in Connecticut by Spector Company than that done by the Alpha Portland Cement Company in Massachusetts.

Where a non-discriminatory tax is levied by a state upon the net income of a foreign corporation derived from business done within the state, the tax is valid even though the corporation is engaged wholly in interstate commerce. Memphis Natural Gas Co. v. Beeler, 315 U. S. 649; Wheeling Steel Corp. v. Fox, 298 U. S. 193; Shaffer v. Carter, 252 U. S. 37; Wisconsin v. Minnesota Mining & Mfg. Co., 311 U. S. 452; United States Glue Co. v. Oak Creek, 247 U. S. 321.

V

The Act applies to domestic and foreign corporations alike and is not discriminatory.

The act applies to both domestic and foreign corporations. The District Court and the Circuit Court of Appeals both held that it was not discriminatory and properly so (R. 97, 122, 123, 124).

Where a state act does not place a discriminatory burden upon interstate commerce merely because it is interstate commerce, Congress and not the courts should determine the extent to which a state may burden interstate commerce. Welton v. Missouri, 91 U. S. 275 (Dissent of Black, J.); McCarroll v. Dixie Greyhound Lines, 309 U. S. 176 (Dissent of Black, J., Douglas, J., Frankfurter, J.); J. D. Adams Mfg. Co. v. Storen, 304 U. S. 307 (Dissent of Black, J.); Gwin, White & Prince, Inc. v. Henneford, 305 U. S. 434 (Dissent of Black, J.).

VI

The computation of the tax is fairly calculated to assign to Connecticut that portion of net income derived from Connecticut.

Petitioner contends that as construed by the respondent in refusing to allow rent to be deducted from gross income, the Act violates the Fourteenth Amendment and the Connecticut Constitution as a tax on gross income in interstate commerce.

In Atlantic Coast Line R. Co. v. Doughton, 262 U. S. 413, 422, the net operating income was reached by deducting certain operating expenses, (which did not include rent), from gross revenues. This determination of net income resembles the determination of net income as defined in the Connecticut statutes.

> "The term 'net income' in law or in economics has not a rigid meaning. Every income tax act necessarily defines what is included in gross income; what deductions are to be made from the gross to ascertain the net income; and what part, if any, of the net income is exempt from taxation. These details are largely a matter of governmental policy. As to them states differ; and there is apt to be difference of view in the same states at different times; and at the same time a different definition of taxable net income for different classes of taxpayers."

Where there is no danger of duplication of taxation by other states or other inequity, a tax measured by gross receipts fairly apportioned to local commerce is valid. Western Live Stock v. Bureau of Revenue, 303 U. S. 250; McGoldrick v. Berwind-White Coal Mining Co., 309 U. S. 33.

A state may tax the gross income of foreign corporations doing business in the state though arising from interstate sales. International Harvester Co. v. Dept. of Treasury, 322 U. S. 340.

The petitioner's local income was found by the application of an allocation fraction which is the mean of three ratios: (1) the ratio of tangible property in the state to all tangible prop-

erty, (2) the ratio of wages and salaries paid within the state to all wages and salaries, and (3) the ratio of gross receipts assignable to the state to all receipts. Sec. 420c, Sec. 3(b) (Appendix A).

The method employed in determining the percent of the net income which is taxable was determined in the following manner:

	Conn.	Total	%
Tangibles	1,500.00	20,985.16	.071479
Salaries & Wages	29,216.11	487,782.41	.059896
Receipts	587,973.59	1,723,510.65	.341149
Total			.472524
Percentage in Connecticut (1/3 of total)			.157508

The method of applying the fraction in determining the amount of the tax due for the year 1940 was as follows:

Net reported Federal	$10,505.86
Add—Rent Paid	22,859.18
Int. Paid	306.04
Truck Hire	396,448.79
Adjusted State Income	430,119.87
Less Sch. D[1]	3,828.86
Subj. to Apportionment	426,291.01
Apportioned %	.157508
After Apportionment	67,144.24
Add D Connecticut[2]	160.00
Taxable	67,304.24
Tax	1,346.08
Paid	—0—
Balance	1,346.08
Penalty	5.00
Interest	72.69
Total	$1,423.77

[1] Unearned income outside of ordinary course of business.
[2] Portion of income not subject to apportionment directly attributable to Connecticut.

As pointed out by the Court of Appeals (R. 113, 125), "the method here employed appears to have produced a result anything but harsh in the light of the large amount of plaintiff's business which originates in this state" as a result of the use of the Connecticut allocation formula inasmuch as the percentage is sharply reduced by the first two ratios, i.e., tangible property and salaries as compared with the third or gross receipts fraction.

As shown in these figures, the Commissioner added to petitioner's federal income and included in the tax base 40% of the amount paid by the petitioner for rent of the trucks belonging to the Wallace Transport Company. The impracticability of establishing a separate ratio for each of the 12,000 corporations in the state was apparent to the Commissioner and with percentages ranging from 37% to 43% based upon the experiences of large truck transportation companies in the state, he established a mean of 40% (R. 76, 77).

The elimination of this 40% would place the petitioner in an advantageous position gained by renting the equipment instead of owning it and would permit tax evasion. W. T. Grant Co. v. McLaughlin, 129 Conn. 663; House of Hasselbach, Inc. v. McLaughlin, 127 Conn. 507; Atlantic Coast Line R. Co. v. Doughton, 262 U. S. 413.

The petitioner has sought by figures of the Interstate Commerce Commission, admittedly not of record in this case, and by a comparison of the Interstate Commerce Commission formula with the Connecticut formula to show that Connecticut is inequitably taxing it. In the Federal formula rent is 100% deductible while in Connecticut's formula rent is deductible only to the extent of 60%. The difference of 40% between the two formulas seriously affects the weight of any persuasive power the petitioner's figures could have.

Also, the petitioner asserts that the State "presumably" did not know until the trial that the petitioner employed and paid the drivers, but that if the State had been aware of this fact all of the amounts paid to Wallace Company would have been disallowed as "rent" and would then have increased the tax

100% over the amounts involved in this case. The "presumption" is entirely lacking in substance because the ratio of allowing 60% reduction for rent and disallowing 40% was arrived at by the Tax Commissioner back in 1935 upon the enactment of the law (R. 80). The Atlantic and Pacific Tea Company raised the issue (R. 76, 78, 80) and their ratio could not possibly have been affected by any such "presumption". The Commissioner interpreted the money paid for the use of the equipment, i.e., the trucks, to be rent and drew a distinction between these payments and normal expenses incurred in the operation of the trucks. A similar distinction is made by the Commissioner respecting road building equipment which is commonly rented by one contractor from another contractor (R. 79). The Great Atlantic & Pacific Tea Co. was satisfied with the ratio and has since continued to pay the tax (R. 77).

The test of any computation of net income is whether or not it is fairly calculated to assign to Connecticut the net income reasonably attributable to the State of Connecticut. If the formula employed meets these standards any constitutional question arising under the Fourteenth Amendment is at an end. Butler Bros. v. McColgan, 315 U. S. 501; Bass, Ratcliff & Gretton v. State Tax Commission, 266 U. S. 271; Ford Motor Co. v. Beauchamp, 308 U. S. 331.

Furthermore, the burden of attacking the formula was not carried by the petitioner. No evidence was introduced by the petitioner to show that the formula was not calculated to assign to Connecticut that portion of the business reasonably attributable to Connecticut. Now for the first time the petitioner by the use of extraneous matter, i.e., figures of the Interstate Commerce Commission, attempts to attack the Connecticut formula. Thus with argument and not with evidence petitioner attempts to show that the formula of apportionment has placed a distinct burden upon it resulting in extraterritorial values being taxed.

> "One who attacks a formula of apportionment carries a distinct burden of showing by 'clear and cogent evidence' that it results in extraterritorial values being

taxed. See Norfolk & Western Ry. Co. v. North Carolina, 297 U. S. 682, 688, 56 S. Ct. 625, 628, 80 L. Ed. 977. This Court held in Hans Rees' Sons, Inc. v. North Carolina, supra, 283 U. S. 135, 51 S. Ct. page 389, 75 L. Ed. 879, that that burden had been maintained on a showing by the taxpayer that 'in any aspect of the evidence' its income attributable to North Carolina 'was 'out of all appropriate proportion to the business' transacted by the taxpayer in that State. No such showing has been made here."

Butler Bros. v. McColgan, 315 U. S. 501:

Petitioner contends that the tax operates on a gross income because the rent is actually an operating expense. It sets aside the separate entity of the Spector Company and the Wallace Company and attributes to the Spector Company the losses of the Wallace Company (Ex. 16, R. 57, 58). As stated by the Court of Appeals (R. 126), the entire payment by Spector Company to Wallace Company was for the lease of the trucks and was "perhaps more than fair, on its face, as to the taxpayer concerned" (R. 126, 127). See "Intent of Special Tax Commission", in "Conclusion" of this brief for examples illustrating this point in greater detail.

It seems to us that due to the separate entity of the two companies Spector Company can have no concern with what Wallace Company does with the money paid to it by Spector Company. If the state were to tax Wallace Company as well as Spector Company, the objection would be immediately raised that they are different corporations and under the law separate entities and not subject to the tax.

The petitioner welcomes the legal theory of separate entities where its application has saved petitioner payment of taxes to the various states through which Wallace Company trucks run with Spector Company merchandise, but would cast aside such theory in an attempt to avoid this tax. In arguing that rent of the trucks is an operating expense to Spector Company, it at one and the same time seeks to avoid the taxes of the various states and this tax by the application of inconsistent and conflicting reasoning.

The contention of the petitioner, based upon figures of the Interstate Commerce Commission that the Connecticut tax tends to annihilate interstate transportation is not borne out by the evidence, as is shown by Exhibit 14 consisting of twelve sheets. The actual amount of the tax is small as compared with petitioner's state income. Assuming that the tax were to be paid when due, and no interest and penalties incurred, the amount of the tax is actually small, as is shown by the following figures:

Period	Gross Business Originating in Connecticut	Amount of Tax
Year ending May 31, 1936	$111,709.97	$618.36
Year ending May 31, 1937	166,610.06	937.98
Jan. 1-May 31, 1938	150,296.95	1,113.56
June 1-Dec. 31, 1938	218,471.73	698.94
Year ending Dec. 31, 1939	505,777.47	1,407.85
Year ending Dec. 31, 1940	587,973.59	1,346.08
Total	$1,740,839.77	$6,122.77

Another contention of the petitioner, based on Exhibit 15 (R. 54, 56) is to the effect that the tax is unfair and inequitable and a violation of due process because the tax increases proportionately with the gross income but has no relation to net income. In the foregoing part of this brief, we have set forth the claim of the State that the tax is based on a fair allocation fraction which affects the business carried on in Connecticut, and to that the respondent adds that it is nothing more than a fair and logical conclusion to assume that if the gross business of the petitioner increases, then its Connecticut business will also show a proportionate increase. Indeed it would be illogical to conclude otherwise, especially because it has been found by the District Court that from one-third to one-half of the dollar volume of petitioner's business originates within the State of Connecticut. (Par. 7 Finding, R. 101, 95).

VII

The statute was properly applied to the petitioner by the Tax Commissioner.

Petitioner claims that its income is not derived from the use of tangible personal property and therefore the allocation was made by the Tax Commissioner by the application of his rules and regulations and not by the statutory allocation fraction; that he used the wrong section of the statute for the allocation; and that the federal and state constitutions were violated because the Commissioner acted in a legislative capacity.

The tangible personal property used by the petitioner is the trucks owned by it and the trucks rented by it, and the tangible real property is the terminals. The operation of the trucks and of the terminals necessitate personal services but one without the other would be useless. In renting and operating the trucks and terminals, the petitioner exercises the rights and privileges of an owner. The petitioner's business comes squarely within Section 420c (3b) and the taxed net income was derived from the "manufacture, sale or use" of tangible personal of real property.

Petitioner contends that the respondent should have applied (3a) of Section 420c instead of (3b) and then relies on State v. Stoddard, 126 Conn. 623, and Connecticut Baptist Convention v. McCarthy, 128 Conn. 701, in support of its contention that local laws should be followed and that the act failed to set up standards or principles to guide the Commissioner in making rules or regulations. The answer to this argument is given by the majority opinion of the Circuit Court of Appeals where it stated that the Connecticut Court in those cases "relies strongly and almost exclusively on the decisions of the Supreme Court of the United States, and we do not believe it intends to adopt a peculiar local rule". 139 F. (2d) 809, 818. In brief, the respondent properly applied Section 420c (3b) and this argument fails for lack of substance. A method of allocation should not be invalidated unless it is clearly improper. Butler Bros. v. McColgan, 315 U. S. 501.

VIII

The possibility that other states may tax the petitioner does not excuse it from paying the tax.

The petitioner claims that if Connecticut can subject it to this tax, it might suffer multiple taxation from other states and incur great losses, but no evidence of such an occurrence exists and petitioner admits that no other state has imposed such a tax. The vague possibility of such an occurrence cannot excuse the petitioner from its just share of the tax burden. Northwest Airlines v. State of Minnesota, 64 S. Ct. 950; Henneford v. Silas Mason Co., 300 U. S. 577; Gwin-White & Prince, Inc. v. Henneford, 305 U. S. 434 (Dissent of Black, J.). In International Harvester Co. v. Dept. of Treasury, 322 U. S. 340, 348, the Court dismissed such an argument with these words: "But it will be time to cross that bridge when we come to it".

By the ingenious application of figures the petitioner, with the aid of many "ifs", has attempted to show that a like tax "if" applied by all the states through which the petitioner operates would exceed the income of the petitioner. We have answered that the vague possibility of such an occurrence cannot of itself defeat the tax levied by Connecticut. The petitioner, however, does not stop here; it goes on to suppose that "if" Connecticut and all the states should withdraw the 60% allowance for expenses in connection with purchased transportation, the result would be an increase of 150%. The answer is self-evident. Petitioner has itself admitted that no other state has a similar law. Should the states attempt to enact such a law, then at that time the court will consider the problem of multiple taxation. Henneford v. Silas Mason Co., 300 U. S. 577, 587. Also, Connecticut has arrived at the 60-40 ratio after serious consideration and investigation based upon the activities of 12,000 corporations carrying on business in the state, (R. 76, 77), and there is no evidence that Connecticut considers that the ratio was based upon any misunderstanding of the facts; nor is there any indication that Connecticut will withdraw the 60% allowance or change the ratio in any respect.

IX

Conclusion

By invoking the protection of the Commerce Clause, the petitioner has been able to avoid its just share of the tax burden on the premise that it is engaged solely in interstate commerce. It has avoided paying corporation taxes to any state where it transacts business and the record shows the skill displayed by petitioner in avoiding taxation.

Consider the history of this company. A Missouri corporation, with a small capital; it engaged in the very competitive field of transportation shared by railroads and large trucking concerns. It mushroomed from a small company in 1933 to a company having an income of about one-quarter of a million dollars two and one-half years after its inception, and an income of about one and three-quarters million dollars six and one-half years after its inception. The fact that it paid no state corporation taxes contributed largely to its success.

Originally it leased all its trucks. Then it formed an Illinois corporation which it called the Wallace Transport Company. All the stock in this company is owned by two men and their wives, the same two men who own all the stock of the Spector Company (R. 26). The Spector Company established the Wallace Transport Company in business by purchasing all its trucks with money of Spector Company and now designates Wallace Company as the "equipment-owning affiliate" of the Spector Company (R. 30). The drivers of Wallace Company are the employees of Spector Company (R. 32). The Wallace Company has its principal place of business in Chicago. Petitioner changed its administrative office from St. Louis to Chicago. The reason is apparent when it appears that Missouri has no reciprocity with Illinois, Ohio or Indiana, whereas Illinois, Ohio and Indiana do have reciprocity among themselves. The Wallace Transport Company with Illinois license plates does not have to pay the following taxes: (1) Weight and tire tax in Indiana, (2) registration tax in Ohio, and (3) flat rate tax in Illinois.

As a Missouri corporation the petitioner would otherwise have to pay these taxes. The merged relationship of the Spector Company and Wallace Company is frankly admitted by the secretary, treasurer and general counsel of the Spector Company (R. 30-32, 48, 49).

The following illustration sheds some light on the success of the methods used by the Spector Company in avoiding state taxes through the formation of the Wallace Company.

Illinois issues two types of plates, the T plate and the X plate. The T plate is a plate issued whereby the trucker pays two cents a mile for every mile the truck operates in Illinois. The X plate is a plate issued to cars of foreign registry permitting these trucks to run in the State of Illinois. The flat rate charge for the X plate is $250 a truck (R. 31).

From the border of Illinois to the office of the Wallace Company is a run of only seventeen miles in Illinois. This means a charge of $.68 a round trip. An officer of the company estimated a truck made four and one-third round trips a month, or paid about $3.00 a month for each truck under the T plate. This sum amounts to $36.00 a year tax for each truck under the T plate. If an X plate was issued the yearly cost would be $250.00 a year per truck. (R. 31). Multiply these costs by the number of trucks operated by Wallace Company, all for the benefit of petitioner, and under petitioner's exclusive manipulation, and we have, on the one hand, one hundred fifty trucks at $36.00 a year tax for operation, or a total tax payment of $5,400.00, as against one hundred fifty trucks at an annual rate of $250.00 per truck, or a tax payment of $37,500.00 per year, resulting in a tax saving of $32,100.00 on this item alone in one year. This saving is accomplished by the Spector Company on just one of the taxes mentioned above.

The following corporate state fees are magnanimously paid by the Company: $50 to Connecticut for the privilege of doing business as a foreign corporation in Connecticut, $75 franchise fee to Illinois for its operations in that state, and $75 to Missouri for its operations there. Its franchise fee payments in 1940, on a gross business of one and three-quarter millions

of dollars, amounted to $200. On all its Connecticut business from 1936 to 1940, totalling $1,740,785.77, it has paid the sum of $50 each year for five years, or $250. The reason the petitioner showed a phenomenal growth throughout even the so-called depression years is obvious.[3]

Upon the facts of the case it is fair to state that in line with its desire to avoid paying taxes the petitioner did not seek a certificate from the Connecticut Public Utilities Commission. It places reliance upon the decision of the Connecticut Supreme Court of Errors in Underwood v. Chamberlain, 94 Conn. 47, 55. Respondent respectfully submits that the 1935 Act was enacted after this decision was rendered and one of its purposes was to change the law so that corporations such as the petitioner might be compelled to carry their just share of the tax burden. If this were not so, it would be reasonable to believe that the Temporary Tax Commission and the legislature would have left the law as it was.

It is not a fair interpretation of the Commerce Clause that a company manipulated like this can abuse the protection afforded by it. It clearly works to the detriment and extreme disadvantage of competing carriers. The petitioner even considers the $50 annual fee paid to Connecticut for the privilege of doing business as a foreign corporation therein to be a gift since it anomalously denies doing business in the state.

It is obvious that by virtue of the protecting screen of a claim of burden on interstate commerce, the petitioner has thus far successfully avoided paying its share of corporate taxes to any state in which it does business.

To declare a corporation engaged as the petitioner is engaged in doing business in Connecticut immune from the tax, the result would be discrimination against intrastate businesses which are as much entitled to constitutional protection from discrimination as interstate commerce. Adams Mfg. Co. v. Storen, 302 U. S. 307 (Dissent of Black, J.)

Respondent has denied petitioner's assertion that the respondent has never before attempted to apply this tax with references to the record (R. 76, 77, 80). To petitioner's claim

that this is good faith litigation and consequently penalties and interest should not be recovered by the respondent in the event this Court should find petitioner liable for the tax, respondent refers to Sec. 423c of the Act which provides that a corporation may file with the Commissioner its objections to the tax as applied to it and may suggest a substitute allocation method. The petitioner has never availed itself of the remedy provided by this statute even though the statute permits objections where the allocation subjects it to a tax "on a greater portion of its business than is reasonably attributable to this state". The petitioner is in reality merely seeking to avoid paying a tax and should be treated no differently than any other taxpayer who may be found delinquent under Section 360e of the 1939 Supplement to the General Statutes, Rev. 1930. (See Sec. 360e attached to each Exhibit 14).

THE INTENT OF THE SPECIAL TAX COMMISSION

The special tax commission believed that any corporation having sufficient net earnings should pay a business tax equivalent to 2% of its net earnings from Connecticut business in the event that such net earnings tax would be in excess of the minimum tax. It should be emphasized that this part of the new corporation business tax was measured by net earnings and not by net income. The net earnings of a corporation may be said to be equivalent to the sum of its net income and of the interest on borrowed money and rent on leased real estate which may have been paid by it. The special tax commission pointed out that a business tax should not depend upon the manner of the financial organization of a corporation but rather upon the amount of business done by it. The volume of business carried on by any corporation is not related to the amount of money invested by its stockholders themselves or to the equity of its stockholders in its assets, but rather in the aggregate amount of capital used in the business of that corporation whether that capital be borrowed, rented or contributed by its stockholders.

In order to be as fair and equitable as possible to all corporations a franchise tax for the privilege of carrying on business should be measured by the net earnings of each corporation. An example will illustrate. Four corporations decide to engage in the same kind of business. All have high-grade managership of equal calibre. Corporation A, however, obtains all of its capital of $1,000,000 to be used in its business from its stockholders alone. Of the amount so obtained, $500,000 is used in the purchase of land and the construction of a factory thereon; $300,000 is used in the purchase of machinery; and $200,000 in the purchase of raw material. At the end of the first year this corporation has net earnings of $100,000. This amount is also the same as its net income since it has no expenditures for interest on borrowed money or rent on real estate leased by it.

Corporation B obtains $500,000 from its stockholders and $500,000 from the issuance of 4% bonds. Since it also has $1,000,000 with which to carry on its business, it is able to construct the same sized plant, install the same type of machinery, and have the same amount of raw material as Corporation A. At the end of the first year Corporation B also has net earnings of $100,000. Since, however, it has to pay $20,000 to its bondholders, its net income amounts to only $80,000.

Corporation C obtains $500,000 paid-up capital stock from its shareholders, and instead of buying land and erecting its own factory, it decides to rent real estate having a valuation of $500,000 in which it installs machinery worth $300,000 and also has $200,000 to be used in the purchase of raw material. Corporation C also has $1,000,000 to work with, and also has net earnings at the end of the first year of $100,000. Because, however, it has to pay $50,000 rent for its leased real estate, its net income is only $50,000.

Corporation D is only able to raise $200,000 from its stockholders. It rents real estate, however, valued at $500,000 and also rents machinery placed in that factory of a value of $300,000. Since it also has a capital of $1,000,000 with which

to work it is able at the end of the first year to have $100,000 in net earnings. Because, however, it has to pay $50,000 in rent on leased real estate and $30,000 in rent on rented machinery, its net income is only $20,000.

Since it is the purpose of the net earnings tax base of the present Connecticut corporation business tax act to measure that tax by the amount of business done by each corporation, all four corporations in the example illustrated will pay the same amount of tax. This is as it should be since each has the use of the same amount of capital and each carries on the identic volume of business.

In order to achieve this purpose, however, it is necessary to add to the net income which any corporation may have enjoyed, all amounts which may have been paid by it in rent for the use of leased real estate and of tangible personal property, and in interest payments on borrowed money.

It will be seen that there would have been discrimination against Corporation A in the event that it had been required to pay a corporation business tax of $2,000 while its competitor B had to pay a tax of $1,600; its competitor C, a tax of $1,000; and its competitor D, a tax of only $400.

Relative to depreciation the theory behind the present law will not warrant the non-deductibility of charge-offs for depreciation. What the special tax commission had in mind was the use of capital, not the consumption of capital.

If charge-offs were not allowed as a deduction there would be discrimination between the corporation owning real estate and the corporation renting real estate. This is due to the fact that unless the owner of the building which is leased to the corporation keeps that building entirely up to date, he will be forced to reduce his rent or to lose his tenant. In order to avoid this he will sooner or later have to spend capital which may be roughly equivalent to depreciation which has been taken on the building. If this is true, it would appear that a corporation which owns its own real estate should be given the privilege of deduction of legitimate charge-offs for depreciation.

There is a fundamental distinction between the consumption of capital and the current use of capital.

The members of and advisors to the special tax commission who went painstakingly into the economic theory behind the present law came to the conclusion that in their essence there is no fundamental distinction between interest and rent. One merges into the other.

Theoretically it should make no difference as to whether the corporation borrows $500,000 through the issuance of 4% bonds and itself erects its factory plant from such borrowed money, or whether that corporation borrows no money, but rents a factory plant having a value of $500,000. In the one case the corporation pays interest, and in the other case it pays rent. If the corporation which borrows $500,000 and puts up its own plant is not careful to set up proper reserves for depreciation to take care of the consumption of the plant erected by it, the day will inevitably arrive when its plant will be valueless, and it will still owe $500,000. On the other hand if the landlord of the corporation which rents real estate does not take care to see that the real estate originally worth $500,000 is not properly kept up in every particular and replacements are made for deterioration, depreciation and obsolescence, the corporation so renting will in time either give up its lease, or see to it that the rent paid by it is commensurate with the decreased value of the rented real estate.

In order to be fair to both corporations, although no allowance should be made for the deduction of rent or interest paid by the corporation, legitimate depreciation charge-offs in the case of a corporation owning its own plant should be allowed.

So far as is known there is no state in the union at the present time which has so painstakingly attempted to establish justice and equity as between all corporations in the levy of corporation business taxes as has Connecticut. At the same time a fair income is assured for the state.

For all of the foregoing reasons, the judgment of the Circuit Court of Appeals should be affirmed.

Dated at Hartford, Connecticut,
this 30th day of October, 1944

Respectfully submitted,

RESPONDENT
By: FRANCIS A. PALLOTTI,
Attorney General of the State of Connecticut.

FRANK J. DISESA,
Assistant Attorney General of the State of Connecticut.
His Counsel.

To be argued by:
FRANK J. DISESA,
Assistant Attorney General

APPENDIX A

Section 418c, 1935 Supplement to the General Statutes:

Sec. 418c. Imposition of tax. Every mutual savings bank, and loan association on having the right to carry on other corporation or ate which is required to report to the collector of internal revenue for the district in which such corporation or association has its principal place of business for the purpose of assessment, collection and payment of an income tax, except (1) insurance companies, (2) companies principally engaged in the transportation and communication business and subject to the gross earnings taxes under chapters 70, 71 and 72, (3) companies principally engaged in manufacturing, selling or distributing gas, electricity or water and subject to the gross earnings tax imposed under chapter 73 and (4) companies all of whose properties in this state are operated by companies subject to taxation under chapter 70, 71, 72 and 73, shall pay, annually, a tax or excise upon its franchise for the privilege of carrying on or doing business within the state, such tax to be measured by the entire net income as herein defined received by such corporation or association from business transacted within the state during the income year and to be assessed at the rate of two per cent; provided in no case shall the tax be less than the minimum tax as computed under section 421c and provided, when any company taxable under chapter 71 shall engage in any business in this state other than the carrying of passengers for hire in common carrier motor vehicles, such company shall be subject to a tax of two per cent measured by that portion of its total net income derived from such business but shall not be subject to the minimum tax computed under section 421c. Notwithstanding any other provisions of this chapter, any mutual savings bank owning, at the end of the income year, real estate acquired for debt having an assessed valuation of ten per cent or more of its total assets shall, during the calendar years 1936 and 1937, be subject to the lesser of (1) the tax imposed by this chapter and (2) the

tax imposed by chapter 68 as amended by section 355b of the 1933 supplement.

Section 419c, 1935 Supplement to the General Statutes:

Sec. 419c. Deductions from gross income. In arriving at net income as defined in section 417c whether or not the taxpayer is taxable under the federal corporation net income tax, there shall be deducted from gross income all items deductible under the federal corporation net income tax law effective and in force on the last day of the income year, except (1) federal taxes on income or profits, losses of prior years, interest received from federal, state and local government securities and specific exemptions, if any such deductions shall be allowed by the federal government and (2) interest and rent paid during the income year.

Section 420c, 1935 Supplement to the General Statutes:

Sec. 420c. Allocation of net income. If the trade or business of the taxpayer shall be carried on partly ~~without the~~ state, the business tax shall be imposed on a base which reasonably represents the proportion of the trade or business carried on within the state. The allocation of the base of the tax measured by net income shall be made on the following basis: (1) Interest, dividends, royalties and gains from sales of intangible assets, less related expenses, when received by a company having its principal place of business within the state, shall be allocated to the state and, when received by a company having its principal place of business without the state, shall be allocated without the state; provided, when it can be clearly established that such income is received in connection with business ~~within the~~ state, such income shall be allocated to the state without regard to the location of the principal place of business of the taxpayer, and a similar rule shall apply to such income received in connection with business ~~without~~ the state; (2) gains from sales or rentals of tangible capital assets held, owned or used in connection with the trade or business of the taxpayer but not for sale or for rent in the regular course of business shall be allocated to the state if the property sold or rented be situated in the state prior to the sale or during the

rental thereof, otherwise such gains shall be allocated outside the state; (3) net income of the above classes having been separately allocated and deducted as above provided, the remainder of the net income of the taxpayer shall be allocated and apportioned as follows: (a) Such income, when derived from business other than the manufacture, sale or use of tangible personal or real property, shall be specifically allocated within and without the state under rules and regulations of the tax commissioner; (b) when derived from the manufacture, sale or use of tangible personal or real property, the portion thereof attributable to business within the state shall be determined by means of an allocation fraction to be computed as the simple arithmetical mean of three fractions. The first of these fractions shall represent that part of the average monthly fair cash value of the total tangible property held and owned by the taxpayer during the income year which is held within the state, without deduction on account of any incumbrance thereon but excluding any property the income of which is separately allocated under the foregoing provisions of this chapter. The second fraction shall represent the part of the total wages, salaries and other compensation to employees paid by the taxpayer during the income year from offices, agencies or places of business within the state, provided all such payments shall be assigned to the office, agency or place of business of the taxpayer at which the employee chiefly works or from which he is sent out or with which he is chiefly connected. The third fraction shall represent the part of the taxpayer's gross receipts from sales or other sources during the income year, excluding any income which is specifically allocated under subdivisions (1) and (2) of this section, which is assignable to offices, agencies or places of business within the state, provided such receipts shall be assigned to that office, agency or place of business at or from which the transactions giving rise thereto are chiefly negotiated and executed.

APPENDIX B

Report of the Connecticut Temporary Commission to Study the Tax Laws of the State and to Make Recommendations Concerning Their Revision (as provided by Special Act No. 474 of 1933 and submitted to the Governor of Connecticut on November 9, 1934).

At page 56:

SUMMARY OF STATE EXPENDITURES.

"From 75 to 80 per cent of all state expenditures from 1927-28 to 1932-33 were made for highways, charities and corrections, and education. Highways required from 33 to 47 per cent of all state expenditures; charities and corrections, from 20 to 32 per cent; and education, from 12 to 14 per cent. All other state functions, consisting of general government, protection of persons and property, development and conservation of natural resources, conservation of health and sanitation, public parks, interest, and miscellaneous, accounted for less than 25 per cent of all state expenditures."

At pages 451-456:

ALLOCATION OF NET INCOME.

"The apportionment of net income is one of the principal problems which has been faced by the tax commissioner in the administration of the law. The courts have held that apportionment of net income between the several states in which a taxpayer does business must be reasonable and equitable. An arbitrary allocation fraction will be sustained in the absence of convincing evidence as to its unreasonable effect. With the 1933 amendment to the Connecticut statutes, requiring the use of separate accounting in certain cases in the allocation process, the law has been rendered much less vulnerable than it formerly was. But the danger now is that this allocation method will be demanded by taxpayers whose cost accounting systems are not sufficiently accurate to warrant its

use. The tax commissioner is left with only the vaguest sort of authority to pass upon the accuracy of such systems.

"When the taxpayer is unable to qualify for allocation by the separate accounting method, its income is allocated by formulas which differ from those in use in any other state. This means that the corporation doing business within and without this state is taxed upon more or less than 100 per cent of its net income in all but the most unusual cases.

[1] Hans Rees' Sons v. State of North Carolina, 283 U. S. 123 (1931).

A BROADER CONCEPT OF NET INCOME.

DENYING DEDUCTIONS FOR INTEREST AND RENTAL PAYMENTS.

"A business tax should not depend upon the financial organization of a corporation but rather upon the amount of business done. This is not related to the amount of capital invested by stockholders or the equity of stockholders in the assets of the corporation, but rather to the amount of capital used in the business whether borrowed or contributed by stockholders. To satisfy this requirement, it is necessary to redefine net income so as to include payments and accruals to the credit of all contributors of capital—that is, rental and interest payments and accruals as well as net profits.

"It has been shown that only by such a definition of net income can the tax contributions of banks be maintained at somewhere near their former level by means of a valid tax and without substantially increasing the burden of taxes upon other corporations to which the net income or franchise tax upon national banks is tied by the provisions of section 5219 of the federal statutes. But whatever the disposition by the General Assembly of our recommendations for the taxation of banks, we are convinced that the changes which we are proposing at this point in the base of the tax upon miscellaneous corporations will make for a more equitable distribution of the tax burden among these corporations and will at the same time introduce a stabilizing factor into the tax base which will be of great value in itself.

"Such modification, however, raises two questions: Will such a tax be interpreted as a burden upon interstate commerce? Will the apportionment of net earnings between states by means of arbitrary allocation fractions be held unreasonable?

"These questions may be clarified by considering the fact that the returns realized by stockholders upon their investments in a corporation are somewhat analogous to the returns realized by bondholders and lessors. It has long been recognized that stockholders' net income consists not only of fortuitous gains but also of implicit (i.e., non-contractual) interest and rent upon the investment of stockholders.

"It is generally conceded that a tax cannot be imposed upon gross receipts from interstate commerce.[15] On the other hand, it is equally well established that a net income tax can extend to profits from interstate commerce.[16] The base rather than the rate of the tax is thus established as a determining factor in questions of interpretation of the interstate commerce clause. The dicta of the court in the decisions which it has rendered on this score cannot be interpreted too literally. It is obvious that a net income tax so heavy as to encroach severely upon the normal profits of a concern may discourage interstate commerce more effectively than a moderate gross income tax. The probability is that the court would give some consideration to the burden if faced with cases involving extreme rates. But there is no probability that such rates will be imposed by this state. The only question then is the interpretation which the courts will place upon a tax base of the type under consideration.

"There is, so far as we are aware, only one decision in which the Supreme Court has ruled upon a net earnings tax. In the case of Atlantic Coast Line Railroad Co. v. Doughton (262 U. S. 413) previously cited, one of the points at issue was the burden imposed upon interstate commerce by a net income tax which,

[15] Crew Levick Co. v. Commonwealth of Pennsylvania, 245 U. S. 292 (1917).

[16] U. S. Glue Co. v. Oak Creek, 247 U. S. 321 (1918).

in the case of railroads and other public utility companies, was imposed upon a base consisting of interest and rental payments as well as net profits. The tax was upheld by the court.

"We conclude that a net earnings tax could be extended to earnings from interstate commerce because, as far as the burden imposed by it is concerned, there is no fundamental difference between such a tax and a net income tax of the ordinary type, and because such a tax has been specifically upheld by the United States Supreme Court.

"The allocation of net earnings would, we believe, constitute no obstacle to the enforcement of a net income tax framed along these lines. Gross receipts can be allocated with less difficulty than net income among the states in which business is conducted. So too can such expenses as raw materials, wages, insurance, etc. But such overhead costs as interest on indebtedness and salaries can be apportioned among the several states only upon some arbitrary basis. Hence, the fewer such deductions, the simpler becomes the allocation by a separate accounting process.

"The allocation by means of an arbitrary apportionment fraction would, of course, continue to be the common practice, but since there is no fundamental difference, as far as the geographic source of income is concerned, between income which is earned for stockholders and income which is earned for creditors and lessors, there is no reason why an apportionment fraction which will be sustained for an ordinary net income tax will not also be sustained for a net earnings tax. It may be noted that the Atlantic Coast Line case arose over a tax which was apportioned according to the ratio of mileage within and without the state of North Carolina and that the tax was not attacked upon this point." (Parenthetical matter ours.)

SUPREME COURT OF THE UNITED STATES.

No. 62.—October Term, 1944.

Spector Motor Service, Inc., Petitioner, vs. Charles J. McLaughlin, Tax Commissioner, Walter W. Walsh, Substituted Defendant.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[December 4, 1944.]

Mr. Justice Frankfurter delivered the opinion of the Court.

This is a suit brought in a United States district court to enjoin the enforcement of a State tax and for a declaratory judgment.

The Connecticut Corporation Business Tax Act of 1935, as amended, imposed on every corporation, not otherwise specially taxed, carrying on, or having the right to carry on business within the State "a tax or excise upon its franchise for the privilege of carrying on or doing business within the State. . . ." Conn. Gen. Stat. Cum. Supp. 1935, § 41se, as amended by Conn. Gen. Stat. Supp. 1939, § 354c. Petitioner, a Missouri corporation with its principal place of business in Illinois, is engaged exclusively in the interstate trucking business. It is neither authorized by Connecticut to do intrastate trucking nor in fact does it engage in it. It maintains two leased terminals in Connecticut solely for the purpose of carrying on its interstate business. At the request of its lessor, it has filed with the Secretary of State in Connecticut a certificate of its incorporation in Missouri, has designated an agent in Connecticut for service of process, and has paid the statutory fee. On this state of facts the State Tax Commissioner determined that petitioner was subject to the Act of 1935, as amended, and assessed the tax against Spector for the years 1937 to 1940. Whereupon petitioner brought this suit in the United States District Court for the District of Connecticut to free itself from liability for the tax. Alleging appropriate grounds for equitable relief, petitioner claims that the "tax or excise" levied by the Act does not apply to it, and in the alternative that, if it should be deemed within the scope of the statute, the tax offends provisions of the Connecticut Constitution as well as the Commerce and Due Process Clauses of the United States Constitution.

The District Court construed the statute to be "a tax upon the exercise of a franchise to carry on intrastate commerce in the state" and therefore not applicable to petitioner. 47 F. Supp. 671, 675. On appeal the Circuit Court of Appeals for the Second Circuit construed the statute to reach all corporations having activity in Connecticut, whether doing or authorized to do intrastate business or, like the petitioner, engaged exclusively in interstate commerce. It further decided all contentions under the Connecticut Constitution against the petitioner. And so the court below found itself compelled "to face directly the main issue whether the tax is in fact an unconstitutional burden on interstate commerce". 139 F. 2d 809, 813. The dissenting judge thus phrased the issue: "we have before us in the barest possible form the effort of a state to levy an excise directly upon the privilege of carrying on an activity which is neither derived from the state, nor within its power to forbid". *Id.* at 822. It was conceded below that if the Connecticut tax was construed to cover petitioner it would run afoul the Commerce Clause were this Court to adhere to what Judge Learned Hand called "an unbroken line of decisions". On the basis of what it deemed foreshadowing "trends", the majority ventured the prophecy that this Court would change its course, and accordingly sustained the tax. In view of the far-reaching import of such a disposition by the Circuit Court of Appeals we brought the case here. 322 U. S. 720.

Once doubts purely local to the Constitution and laws of Connecticut are resolved against the petitioner there are at stake in this case questions of moment touching the taxing powers of the States and their relation to the overriding national interests embodied in the Commerce Clause. This is so whether the issue be as broad and as bare as the District Court and Judge Learned Hand formulated it, or whether the Connecticut statute carries a more restricted meaning. If Connecticut in fact sought to tax the right to engage in interstate commerce, a long course of constitutional history, and "an unbroken line of decisions" would indeed be brought into question. But even if Connecticut seeks merely to levy a tax on the net income of this interstate trucking business for activities attributed to Connecticut, questions under the Commerce Clause still remain if only because of what the court below called "ingenious provisions as to allocation of net

income in the case of business carried on partly without the state". 139 F. 2d 809, 812.

We would not be called upon to decide any of these questions of constitutionality, with their varying degrees of difficulty, if, as the District Court held, the statute does not at all apply to one like petitioner, not authorized to do intrastate business. Nor do they emerge until all other local Connecticut issues are decided against the petitioner. But even if the statute hits aspects of an exclusively interstate business, it is for Connecticut to decide from what aspect of interstate business she seeks an exaction. It is for her to say what is the subject matter which she has sought to tax and what is the calculus of the tax she seeks. Every one of these questions must be answered before we reach the constitutional issues which divided the court below.

Answers to all these questions must precede consideration of the Commerce Clause. To none have we an authoritative answer. Nor can we give one. Only the Supreme Court of Errors of Connecticut can give such an answer. But this tax has not yet been considered or construed by the Connecticut courts. We have no authoritative pronouncements to guide us as to its nature and application. That the answers are not obvious is evidenced by the different conclusions as to the scope of the statute reached by the two lower courts. The Connecticut Supreme Court may disagree with the District Court and agree with the Circuit Court of Appeals as to the applicability of the statute. But this is an assumption and at best "a forecast rather than a determination". *Railroad Comm'n.* v. *Pullman Co.*, 312 U. S. 496, 499. Equally are we without power to pass definitively on the other claims urged under Articles I and II of the Connecticut Constitution.[1] If any should prevail, our constitutional issues would either fall or, in any event, may be formulated in an authoritative way very different from any speculative construction of how the Connecticut courts would view this law and its application. *Watson* v. *Buck*, 313 U. S. 387, 401-402.

If there is one doctrine more deeply rooted than any other in the process of constitutional adjudication, it is that we ought not

[1] For instance, petitioner claims that no standard for assessment is set up in the statute so that the executive officer is acting in a legislative capacity in violation of Article II; the failure to allow a deduction for rent violates Sections 1 and 12 of Article I. In addition he claims that the tax was assessed under the wrong subsection of the statute—§ 420c(b) instead of § 420c(a).

to pass on questions of constitutionality—here the distribution of the taxing power as between the State and the Nation—unless such adjudication is unavoidable. And so, as questions of federal constitutional power have become more and more intertwined with preliminary doubts about local law, we have insisted that federal courts do not decide questions of constitutionality on the basis of preliminary guesses regarding local law. *Railroad Comm'n* v. *Pullman Co.*, *supra*; *Chicago* v. *Fieldcrest Dairies*, 316 U. S. 168; *In re Central R. Co. of New Jersey*, 136 F. 2d 633. See also *Burford* v. *Sun Oil Co.*, 319 U. S. 315; *Meredith* v. *Winter Haven*, 320 U. S. 228, 235; *Green* v. *Phillips Petroleum Co.*, 149 F. 2d 466; *Findley* v. *Odland*, 127 F. 2d 948; *United States* v. *159.29 Acres of Land*, 135 F. 2d 878. Avoidance of such guesswork, by holding the litigation in the federal courts until definite determinations on local law are made by the state courts, merely heeds this time-honored canon of constitutional adjudication.

We think this procedure should be followed in this case. The District Court had jurisdiction to entertain this bill and to give whatever relief is appropriate despite the Johnson Act[2] and *Great Lakes Co.* v. *Huffman*, 319 U. S. 293, because of the uncertainty surrounding the adequacy of the Connecticut remedy. See *Waterbury Savings Bank* v. *Lawler*, 46 Conn. 243; *Wilcox* v. *Town of Madison*, 106 Conn. 223, 137 Atl. 742. But there is no doubt that Connecticut makes available an action for declaratory judgment for the determination of those issues of Connecticut law involved here. *Charter Oak Council, Inc.* v. *Town of New Bedford*, 121 Conn. 466, 185 Atl. 575; *Conzelman* v. *City of Bristol*, 122 Conn. 218, 188 Atl. 659; *Walsh* v. *City of Bridgeport*, 2 Conn. Supp. 88.

We therefore vacate the judgment of the Circuit Court of Appeals and remand the cause to the District Court with directions to retain the bill pending the determination of proceedings to be brought with reasonable promptitude in the State court in conformity with this opinion.

Mr. Justice Douglas concurs in the result. Mr. Justice Black dissents.

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[2] Act of August 21, 1937, 50 Stat. 738, 28 U. S. C. § 41 (1). "... no district court shall have jurisdiction of any suit to enjoin, suspend, or restrain the assessment, levy, or collection of any tax imposed by or pursuant to the laws of any State where a plain, speedy, and efficient remedy may be had at law or in equity in the courts of such State ...".